Supreme Court of the United States

OCTOBER TERM 1948

No. 88

NATHAN D. LEIMAN and SAMUEL MARION,

Petitioners,

against

ALEXANDER GUTTMAN, GEORGE GELLER and ARTHUR BAINTON, individually and as officers and members of the Committee of Preferred Stockholders of Pittsburgh Terminal Coal Corporation, HOWARD S. GUTTMAN, MONROE GUTTMAN, RUDOLPH GUTTMAN, IRENE GUTTMAN and ELIZABETH WOLFERS,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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Nature of Matter Involved

There is serious doubt that the petitioners have properly noted jurisdiction in this court pursuant to Section

237(b) Judicial Code (28 U. S. C. 344(b)), and Rule 38, Subdivision 5(a) of the Rules of the Supreme Court.[1]

A brief recital of the background of the controversy demonstrates that jurisdiction in this court is not free from uncertainty.

The action was started by the service of a summons and complaint, in the New York State Supreme Court. The complaint was thereafter amended (R. 8). The amended complaint alleges a hiring of the petitioners by the respondents for services rendered to the respondents in a proceeding under Chapter X of the Bankruptcy Act,

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1. This court appears to have uniformly held that the petitioner must have pleaded a right, title, privilege or immunity under the United States Constitution or a federal statute.

In *Chesapeake and Ohio Railroad Company* v. *McDonald* (1909), 214 U. S. 191 at page 193, this court stated:

> "In this class of cases, the statute requires that such right or privilege must be specifically set up and claimed in the state court * * * and decided it adversely to the claim of the plaintiff in error."

That it is essential there be a denial of the claim was further noted in *Dewey* v. *Des Moines* (1899), 173 U. S. 193, at page 198.

> "In other words, the court must be able to see clearly from the whole record that a provision of the Constitution or Act of Congress is relied upon by the party who brings the writ of error and that the right thus claimed by him was denied."

In *Steele* v. *Louisville & Nashville R. R. Company* (1944), 323 U. S. 192, at page 204, this court noted jurisdiction under section 237b of the Judicial Code (28 U.S.C. 344(b)).

> "Since the right asserted by petitioner is * * * claimed under the Constitution' and a 'statute of the United States' the decision of the Alabama Court, adverse to that contention, is reviewable here * * *."

Home for Incurables v. *New York* (1902), 187 U. S. 155, at page 158.

> "In the case before us, the Home for Incurables has not brought upon the record the fact that it asserted, in the state court, any Federal right whatever. It is entirely consistent with the record that the home did not, at any time pending the case in the state court, set up or claim any such right. If our jurisdiction is invoked on the ground that the judgment of the state court has denied a right, title, privilege or immunity secured by the Constitution of the United States, it is essential, under existing statutes, that such right, title, privilege, or immunity shall have been specially set up or claimed in the state court."

To like effect, see *Strader et al.* v. *Baldwin*, 50 U. S. 261, 262.

The petitioners must first demonstrate jurisdiction under section 237(b) (28 U.S.C. 344(b)), before they attempt to qualify under Rule 38(5)(a) of the Rules of the Supreme Court (Hughes on Federal Practice, page 587).

a deposit of 584 shares of stock of the Pittsburgh Terminal Coal Corporation by respondents providing for additional compensation to the petitioners, an allegation of substantial performance of services, and a failure by respondents to turn over said stock to the petitioners. The prayer for relief sought a mandatory injunction ordering respondents to turn over to petitioners herein the shares of stock in question. Annexed to the complaint and marked Exhibit "A" (R. 10-11) is a letter addressed to the petitioners from Alexander Guttman, Chairman of the Stockholders' Protective Committee.

Pursuant to the contract of hiring, petitioners did render professional services in a Chapter X reorganization proceeding then pending and still pending in the Federal District Court for the Western District of Pennsylvania. Thereupon application was made to the Reorganization Court for an allowance of $125,000 upon a full and detailed recital of all services rendered in the reorganization proceeding. Petitioners, in their application, recited all services and made no separation of compensable from non-compensable services, and did not assert that any of the services so rendered were not compensable out of the bankrupt estate. In accordance with the provisions of Chapter X, petitioners made a full disclosure of the execution of the agreement providing for "additional compensation" to petitioners by respondents. The Reorganization Court granted an allowance of $37,500 instead of the $125,000 sought by petitioners. Petitioners feeling aggrieved thereupon sought a modification of that order in that it be made without prejudice to the claim for "additional compensation". The district court refused to pass upon the claim for additional services declining jurisdiction (R. 17). Thereupon, petitioners

instituted this action in the New York State Supreme Court for a mandatory injunction to compel respondents herein to turn over the shares of stock to the petitioners.

The complaint in the action makes no claim that the services rendered requiring the delivery of the shares were of a nature not compensable out of the bankrupt estate. Nor is there any allegation of a denial of a right, title, privilege or immunity under the Constitution of the United States or a federal statute.

The Legal Issue

The respondents, defendants in the court of first instance, in lieu of answering the amended complaint, moved pursuant to Rule 107, subdivision 2 of the Rules of Civil Practice of the State of New York, to dismiss the amended complaint on the ground that the court did not have jurisdiction of the subject matter of the action. That application was grounded on the position that the amended complaint sought compensation for services alleged to have been rendered by the petitioners in connection with a Chapter X reorganization proceeding and that jurisdiction over such claims had been exclusively delegated to the Reorganization Court by the provisions of Chapter X of the Bankruptcy Act. The pertinent sections of the statute will be hereinafter more fully discussed.

The said motion made by respondents to dismiss the amended complaint was denied by the Supreme Court of the State of New York (R. 2, 25). An appeal to the Appellate Division of the Supreme Court of the State of New York was thereafter taken by respondents. The order of the Supreme Court of the State of New York was affirmed by a divided court. Upon application to the Appellate Division of the Supreme Court, a question

was certified to the Court of Appeals of the State of New York for its determination (R. 28, 29). Petitioners now claim that the certified question is too narrow and does not clearly state the issue (P. 5). It is hardly appropriate for the petitioners to complain about the narrowness of the question as it was the question framed by them which was adopted by the Appellate Division of the New York State Supreme Court and certified to the Court of Appeals.

The Court of Appeals of the State of New York reversed the courts below, answered the question certified to it in the negative and granted the respondents' motion to dismiss the amended complaint on the ground that the Supreme Court of the State of New York was without jurisdiction of the subject matter of the action (R. 37). Thus the only legal question which confronted the state court from which review is sought was a local question of the jurisdiction of the state court in an action for services rendered in connection with a proceeding under Chapter X of the United States Bankruptcy Act.

The Constitution, Applicable Statutes and Legislative History

An examination of the Federal Constitution, pertinent federal statutes and legislative history demonstrates that state courts are without jurisdiction of matters in bankruptcy. Article I, section 8, of the Constitution of the United States provides:

> "The Congress shall have power to lay and collect taxes, duties, imposts and excises * * * to establish a uniform rule of naturalization and uniform laws on the subject of bankruptcy throughout the United States."

Congress exercises its power under the Constitution by the enactment of the provisions of the Judicial Code and Judiciary, Section 256 (28 U. S. C. 371), which provides:

> "The jurisdiction vested in the courts of the United States in the cases and proceedings hereinafter mentioned shall be exclusive of the courts of the several states:
>
> * * * * * * *
>
> Sixth: Of all matters and proceedings in bankruptcy."

Section 221(4) of the Federal Bankruptcy Act (11 U. S. C. 621(4)), provides:

> "The judge shall confirm a plan is satisfied that"
>
> * * *
>
> "(4) all payments made or promised by the debtor or by a corporation issuing securities or acquiring property under the plan or by any other person, for services and for costs and expenses in or in connection with, the proceedings or in connection with the plan and incident to the reorganization, have been fully disclosed to the Judge and are reasonable, or if to be fixed after confirmation of the plan, will be subject to the approval of the Judge."

It is obvious that this section does not limit the Bankruptcy Court's powers over fees merely to such as are to be charged to the debtor's estate. It expressly requires disclosure to the Bankruptcy Court of all payments made or promised "either by the debtor" or "by any other person" for services rendered in connection with or incident to the reorganization or the plan and further provides for court approval of such payments

only if the amount agreed upon is "reasonable". Clearly, such explicit and broad language is applicable to the fee agreement which is the subject matter of this action brought in the state court.

Sec. 221(4) was included in Chapter X to provide for broader judicial supervision than that contained in Section 77B of the Bankruptcy Act (11 U. S. C. §207) the predecessor Statute to Chapter X. Subsection (f)(5) of Section 77B (11 U. S. C. §207(f)(5)) provided that "the judge shall confirm the plan if satisfied that * * *.

> "(5) all amounts to be paid by the debtor or by any corporation or corporations acquiring the debtor's assets, and all amounts to be paid to committees or reorganization managers, whether or not by the debtor or any such corporation for services or expenses incident to the reorganization, have been fully disclosed and are reasonable, or are to be subject to the approval of the judge;"

This section provided for judicial scrutiny and approval of fees for services in the reorganization rendered only by "committees or reorganization managers", "whether or not" payable "by the debtor or any corporation or corporations acquiring the debtor's assets." Section 221(4) of Chapter X, on the other hand, is far more comprehensive. It includes fees not only of committees and reorganization managers but of all persons serving in the reorganization in a representative capacity and the bankruptcy court's control applies, as we have seen, both where such fees are paid by the debtor, a successor corporation or by any other person. It is apparent from this analysis that the all-inclusive provisions of Section 221(4) were intended to reach private fee arrangements

between security holders and the attorneys retained to represent them in the reorganization under Chapter X.

The correctness of the construction advanced here of section 221(4) is corroborated by the legislative history.

The report on Chapter X by the Senate Committee on the Judiciary, U. S. Senate Report #1916, 75th Congress, 3rd Session (1938), page 36, states:

> "Subsection (4) of Section 221, derived from Section 77B (f)(5) requires full disclosures and the approval by the judge of all payments for services, and for costs and expenses, in connection with the plan or the proceedings, whether such payments are made or promised by the debtor, or by any corporation suceeding it, or by any other person."

The Commission to Congress in its "Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees", referring to the jurisdiction conferred upon the bankruptcy court under Section 77B and Chapter X, states in Part VIII (1940), pp. 253-4:

> "The supervisory power of the court (under Section 77B) over the amount of the fees received by parties to a reorganization was broader than the court's affirmative power to grant allowances out of the estate to these parties. Thus, any allowance of compensation or reimbursements for expenses, when paid by the debtor or by any new corporation acquiring its assets, was subject to final determination by the court. In addition, it was provided that 'all amounts to be paid to committees or reorganization managers, whether or not by the debtor or any such corporation' must receive the approval of the court as a condition of confirmation of the plan.

"There is little argument against, and much good reason for, subjecting all compensation and expenses, from whomsoever received, to the scrutiny and necessity of approval by the court. The provision last quoted above had the merit of supplying judicial scrutiny in the event, for example, of an attempt to compensate reorganization managers or protective committees by the device of a separate charge upon creditors or stockholders who assented to the plan of reorganization. But it lacked inclusiveness, since in terms it applied only to the fees and expenses of managers and committees. To a limited extent, i.e., as to committee attorneys not paid out of the general estate, the courts were able to overcome this difficulty through use of the so-called 'scrutiny' clause of Section 77B. Thus, where a creditors' committee, in behalf of those whom it represented, contracted to pay its attorney 10 percent of any dividends or proceeds of payment paid to creditors represented by the committee, it was held that this exercise of the committee's power, and hence the attorney's remuneration, was subject to review and modification by the court, through the express power in the statute to scrutinize and disregard committee 'authorizations'. Preferably, however, the court's power over compensation and expenses of any persons concerned in the proceedings should be a plenary power to review their reasonableness, from whatever source paid, and such power has now been granted to the courts by the provisions of Chapter X (Section 221(4))."

Collier, in his work on bankruptcy (p. 3891, 1947 edition), commenting on the broader scope of 221(4) as contrasted with its predecessor section, states:

"The provision remedies a defect of former 77B in that the requirements for disclosure and approval

apply to every payment or promise, whether or not made to committees or reorganization managers, and cover payments or promises made not only by the debtor or successor corporation but also by 'any other person' which includes protective committees, attorneys, agents or representatives, as well as the trustee and other officers of the estate.

* * *

"Under 221(4) the 'bankruptcy court has plenary power to review all fees and expenses in connection with the reorganization, from whatever source they may be payable'. It can hardly be denied that subjecting all compensation and expenses from whomsoever received to court scrutiny is desirable."

Control over all fees by the Bankruptcy Court is an indisputable part of the over-all judicial scrutiny of the reorganization process which the reorganization judge is required to exercise. Such power to scrutinize fee agreements and arrangements is explicitly recognized in section 212 of Chapter X (11 U. S. C. 612), sometimes referred to as "the scrutiny clause", which provides:

"The judge may examine and disregard any provision of a deposit agreement, proxy, power or warrant of attorney, trust mortgage, trust indenture, or deed of trust, or committee or other authorization, by the terms of which an agent, attorney, indenture trustee, or committee purports to represent any creditor or stockholder, may enforce an accounting thereunder, may restrain the exercise of any power which he finds to be unfair or not consistent with public policy and may limit any claim or stock acquired by such person or committee in contemplation or in the course of the proceeding under this chapter to the actual consideration paid therefor."

This provision, it is evident, gives the bankruptcy court extensive powers over those serving in a reorganization, in a representative capacity, and over all agreements and authorizations incident to such representation.

Section 242 (11 U. S. C. 642) permits reasonable compensation for services rendered:

(1) "In connection with the administration of an estate * * *" or

(2) "In connection with the plan approved by the judge."

Section 243 (11 U. S. C. 643) provides as follows:

> "The judge may allow reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred by creditors and stockholders, and the attorneys for any of them, in connection with the submission by them of suggestions for a plan or of proposals in the form of plans, or in connection with objections by them to the confirmation of a plan or in connection with the administration of the estate. In fixing any such allowances, the judge shall give consideration only to the services which contributed to the plan confirmed or to the refusal of confirmation of a plan, or which were beneficial in the administration of the estate, and to the proper costs and expenses incidental thereto."

The language of section 221(4) (11 U. S. C. 621(4)) is considerably broader than that set forth in section 242 (11 U. S. C. 642) and section 243 (11 U. S. C. 643) dealing with compensation out of the assets of the estate. In thus subjecting to judicial scrutiny all payments made or promised, it is clearly the intention of this section of the statute to provide that all payments in the reorgani-

zation proceedings must be made with the approval of the court. Thus it is the responsibility of the reorganization court to supervise the reasonableness of payments for services even when not made out of the estate.

The desire and intent of Congress to abrogate to the federal court exclusive jurisdiction of all federal matters is further demonstrated by section 258 (11 U. S. C. 658), which provides that the federal court shall fix fees for services rendered in prior proceedings whether state or federal. That Congress intended that all fees, allowances and expenses in connection with Chapter X reorganization proceedings are subject to the approval of the Reorganization Court is further borne out by section 216(3) (11 U. S. C. 616(3)) which provides:

> "A plan of reorganization under this Chapter—
> (3) shall provide for the payment of all costs and expenses of administration and other allowances which may be approved or made by the judge."

The Decision of the New York State Court of Appeals is in Accord With the Provisions of the Act and Prior Decisions of this Court

Petitioners in support of their contention that the New York State Court of Appeals incorrectly construed Section 221(4) (11 U. S. C. 621(4)) cite the following cases (P. p. 16):

> *Greensfelder* v. *St. Louis Public Service Company*, 114 F. 2d 53, 59-60, 62 (claim of Carter), 63-64 (claims of Greensfelder and Stein), C.C.A. 8th C. 1940, c.d. 311 U. S. 714;
>
> *In re Mt. Forest Fur Farms of Amerika, Inc.*, 157 F. 2d 640 (C.C.A., 6th C., 1946);

In re Standard Gas & Electric Co., 106 F. 2d 215, 216 (C.C.A., 3rd C., 1939);
Zweifel v. Trans-State Oil Co., 99 F. 2d 650 (C.C.A., 5th C., 1938);
Re Watco Corporation, 95 F. 2d 249, 251-2 (C.C.A., 7th C., 1938);
In re Middlewest Utilities Co., 17 F. Sup. 359, 377 (N.D. Ill., 1936);
In re Paramount-Publix Corporation, 12 F. Sup. 823 (S.D.N.Y., 1935).

A careful analysis of these cases indicates that they were all decided under section 77B of the Chandler Act, subsection (f)(5) (11 U.S.C. 207) which contained features far less comprehensive than chapter X with reference to procedures for supervising fees and allowances. Further, the issue of non-compensable services was not before the Courts in the above cases.

In *Brown* v. *Gerdes*, 321 U. S. 178, Mr. Justice Douglas speaking for this court enunciated the following principle:

> "And Chapter X of the Chandler Act which took the place of §77B set up even more comprehensive supervision over compensation and allowances (H. Rep. No. 1409, 75th Cong. 1st Sess. pp. 45, 46) and provided a centralized control over all administration expenses. • • •
>
> "Thus chapter X not only contains detailed machinery governing all claims for allowances from the estate. It also requires the plan to contain provisions for the payment of all allowances and places on the judge the duty to pass on their reasonableness. The approval of the plan of reorganization has been entrusted to the bankruptcy court exclusively. Even reports on plans submitted by the

> Securities and Exchange Commission are 'advisory only.' §172, 11 U.S.C.A. §572, 3 F.C.A. title 11, §572. It could hardly be contended that the bankruptcy court might dispense with the finding required by §221(2) that the plan is 'fair and equitable, and feasible' and confirm the plan on another basis of delegate the task to another court or agency. See Case v. Los Angeles Lumber Product Co., 308 U. S. 106, 114, 115, 84 L. ed. 110, 119, 120, 60 S. Ct. 1, 41 Am. Bankr. Rep. (NS) 110; Consolidated Rock Products Co. v. Du Bois, 312 U. S. 510, 85 L. ed. 982, 61 S. Ct. 675, 45 Am. Bankr. Rep. (NS) 79. But if that cannot be done, it is difficult to see how a plan could be confirmed which left the approval of certain allowances to a state court. The finding as to allowances required by §221(4) is as explicit and as mandatory as the finding of 'fair and equitable, and feasible' required by §221(2). On each Congress has asked for the informed judgment of the bankruptcy court, not another court or agency. * * *"
>
> "Whatever doubts may have once existed as to the functions of a reorganization court, it is clear under this recent bankruptcy legislation that the approval of all fees as part of the plan has been entrusted to the bankruptcy court exclusively."

Petitioners further seek to support their contention by reference to the cases of *London* v. *Snyder*, 163 Fed. 2 621 (C.C.A. 8th C., 1947) and *Cooke* v. *Bowersack*, 122 Fed. 2 977, (C.C.A. 8th C., 1941) both of which were proceedings arising under Chapter X of the Bankruptcy Act. An examination of these cases merely reveal that the only question involved therein was the amount of allowances paid to counsel out of the debtor's estate, and the power of the Circuit Court to review the determination of the District Court on that question.

Petitioners urge that the language in the last paragraph of the opinion in *Cooke* v. *Bouersack* (cited *supra*) supports their contention. Certainly, nothing is contained therein that can be construed as a finding that the reorganization court did not have jurisdiction over the question of services which were not compensable out of the estate, as that issue was not presented to the court.

Respondents' have always taken the position that they are responsible for non-compensable services, if such were rendered by petitioners, but that the only forum which may consider the question is the reorganization court.

In the language of Justice Douglas, *Brown* v. *Gerdes*, cited *supra* (p. 188);

> "We only hold that the Bankruptcy Court has exclusive authority under Chapter X to fix the allowances for fees."

In the concurring opinion of Mr. Justice Frankfurter in *Brown* v. *Gerdes*, cited *supra*, it is pointed out

> "That where a right arises out of the law of the United States, Congress may, if it sees fit, give to the Federal courts exclusive jurisdiction." (p. 189)

In re McCrory Stores Corp., 19 F. Supp. 917 (S.D.N.Y., 1936), aff'd 91 F. 2d 947 (C.C.A. 2nd C., 1937) c.d. 302 U. S. 725, which was decided under the provisions of section 77B, the reorganization court reduced a fee payable to an attorney for a committee of creditors even though the attorney had a written contract with the committee for a fee far greater than that allowed by the court.

On appeal, the Circuit Court for the 2nd Circuit, affirmed the right of the reorganization judge to reduce fees pay-

able by a creditors' committee pursuant to written agreement to an amount commensurate with the value of the services rendered, even though they be of a non-compensable nature.

The rule was stated as follows:

> "Judge Patterson who made the order held that under sub-division (b)(10) of section 77B 'the duty is laid on the court to see to it that the amount to be received by counsel is no more than commensurate to the services rendered'. Had the reorganization been less successful, he might well have thought the full 10% could fairly be paid, but believing as he did that the agreement was not binding on the court if the compensation under it would result in more than a quantum meruit, he reduced it accordingly * * *. (91 F. 2nd 948)
>
> "When Mr. Cooper continued to perform services in the reorganization proceeding he necessarily acted pursuant to the power of the judge to terminate his contract." (91 F. 2nd 950)

It is noteworthy that in the case of *In re Philadelphia & Reading Coal & Iron Company*, 61 Fed. Supp. 120 (E. D. Pa., 1945), likewise considered under section 77B, the reorganization court not only fixed the amount of compensable services, but when called upon made an allowance for non-compensable services to the attorneys involved. Thus, in passing upon the application of the Philadelphia Bondholders' Committee and counsel the court separated the compensable from the non-compensable services and made an allowance for both.

Kirkpatrick, Justice (p. 127):

> "As pointed out in connection with the request of the indenture trustee, this portion of the services, though in the duties of both committee and counsel

> under their employment and undoubtedly a proper charge against the bondholders, is not compensable by the estate. I fix the reasonable value of such proportion of the services at $7,500 and an allowance from the estate will be made in the amount of $92,500."

The petitioners refer to *In re P. R. Holding Corp.*, 147 F. 2nd 895 (C.C.A. 2nd C. 1945) and attempt to show that the payment of counsel fees for non-compensable services is analogous to brokerage commissions paid to a firm of stockbrokers in connection with the purchase of securities. The court noted the distinction between payments for brokerage commissions and those for fees and allowances for services rendered in a reorganization proceeding.

> "The appellant asserts that Bisgeier & Cohen should have reported the fees paid to Newburger Loeb & Company for acting as broker in the purchase of these certificates. It is true that section 221, subdivision 4, 11 U.S.C.A. section 621, subdivision 4, requires that all compensation for services rendered in the reorganization proceeding or in connection with the plan be submitted to judicial scrutiny. This section aimed to eliminate the practice of fixing reorganization fees and expenses by private arrangement thereby decreasing the effective amount of recovery for the creditors." (p. 899)

The court then concluded that Sec. 221(4) (11 U.S.C. 621(4)) is not applicable to commissions paid to a broker.

The New York State Court of Appeals properly found that a statutory duty had been imposed upon the reorganization court to examine and approve all fees and allowances to the extent that they are reasonable, regard-

less of the source from which they might be payable,[2] that power is vested in the reorganization court and its judicial responsibility can not be delegated to another tribunal. Any other conclusion would frustrate the purposes of the Act and leave security holders exposed to the risk of having their participation reduced through excessive fees, whether by private arrangement or otherwise. The control of fees and allowances exercised by the reorganization court is indispensable to the orderly process of reorganization and cannot be dispensed with or discharged in any other forum.

Conclusion

The petition for a writ of certiorari should be denied for the following reasons:

1. It is extremely doubtful that jurisdiction has been properly noted in this court in accordance with section 237(b) of the Judicial Code (28 U.S.C. 344(b)).

2. Petitioners have not shown, as required by Rule 38, subdivision 5(a) of the Rules of the Supreme Court, that the Court of Appeals of the State of New York has decided a federal question of substance not heretofore determined by this court, or has decided such question not in accord with the applicable decisions of this court.

Respectfully submitted,

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2. *Woods v. City National Bank & Trust Co.*, 312 U. S. 262, 267.